STATE OF NEBRASKA

DEPARTMENT OF INSURANCE
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Director

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BULLETIN

SUBJECT: GAP CONTRACTS IN NEBRASKA

The Department has recently received a number of inquiries regarding the status of GAP contracts in Nebraska. The majority of the inquiries, and the focus of this bulletin, are on debt cancellation contracts whereby the lender agrees to extinguish the debt of the borrower if certain specified events occur. The borrower, in turn, pays an additional fee for the debt cancellation contract or provision.

GAP contracts that are debt cancellation contracts may or may not be considered insurance under Nebraska law, depending on the specific terms of the contract, the parties to the contract, and the contractual arrangements. Although each program would need to be reviewed on a case-by-case basis, certain guidelines are outlined below.

It may be helpful to first provide the definition of insurance in Nebraska and explain how GAP contracts may fit within that definition. The Nebraska Supreme Court, in *Norwest Corp. v. State*, 253 Neb. 574, 583 (1997), listed the elements required for something to be considered "insurance" under Neb.Rev.Stat. §44-102: (1) the existence of a contract whereby, (2) for a consideration, (3) one party (the insurer) promises to pay money or perform a valuable act for the benefit of the other party (the insured), (4) upon the happening of a stated hazard or peril that results in a loss to the insured.

Debt cancellation and deficiency waiver contracts generally fit the definition of insurance. First, the deficiency waiver and debt cancellation agreements are, by definition, contracts in which both parties would have to show their agreement, such as by signing the contracts, in order to be valid and enforceable. Second, the consumer would generally be required to pay an additional amount of funds in order to obtain the deficiency waiver and debt cancellation contract or addendum to the agreement. Third, the lender promises to cancel or suspend the borrower's debt if certain specified events occur, which is a valuable act to the borrower who would otherwise have to continue repaying the loan. Finally, the debt would only be cancelled if certain specified events resulting in a loss to the borrower occur, such as the total loss of a vehicle or the death of the borrower.

Although debt cancellation and deficiency waiver contracts would generally fall within the definition of insurance, lenders such as national banks occupy a special position with regard to such products. National banks are governed under federal law, specifically the National Bank Act. Generally, the Department would not have authority over debt cancellation contracts or contract addendums offered directly to a borrower by a national bank in its role as lender.

In addition, debt cancellation and deficiency waiver contracts between a lender and a borrower in which the only benefit to the borrower is the cancellation of the debt would generally not be considered insurance in Nebraska. Nebraska falls within the territory covered by the Eighth Circuit Court of Appeals. The Eighth Circuit Court of Appeals, in *First National Bank of Eastern Arkansas v. Taylor,* 907 F.2d 775 (1990), stated that when a bank issues a debt cancellation contract in connection with a loan, that contract is different from traditional insurance because the bank does not have to "take an investment risk or make payment to the borrower's estate." The court also noted that solvency concerns behind state insurance regulation would not be implicated with such contracts because, even if the lender went out of business, the debt would be cancelled and the consumer would receive the benefit of the contract.

If, however, the consumer was promised benefits in addition to the cancellation of his or her debt, there is a good chance that the contract would be considered insurance. For example, if the lender promised to provide the consumer a sum of money with which to purchase another vehicle in the event his or her vehicle was totaled, the additional promise would make the contract an insurance contract. The contract has gone beyond self-insurance for the lender, and the consumer may not have the full benefit of the contract if the lender went out of business. As insurance contracts, those debt cancellation or GAP contracts would be subject to the insurance laws of this state.

Similarly, if a third party is involved in the debt cancellation contract, the contract may be insurance or may involve insurance. For example, if a third party (i.e., not the lender) is required to pay off the consumer's loan in the event of a total loss of the vehicle, the contract would involve insurance, not self-insurance.

Basically, if the contract or series of contracts involves anything other than the lender writing off its own loan to the consumer, the contract probably involves insurance and probably would be subject to the insurance laws of this state. Again, the details of each program would need to be evaluated on a case-by-case basis.

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